ILLINOIS COMMERCE COMMISSION

DOCKET NO. 02-0837

SURREBUTTAL TESTIMONY

OF

C. KENNETH VOGL

Submitted On Behalf

Of

CENTRAL ILLINOIS LIGHT COMPANY

d/b/a AmerenCILCO

May 30, 2003

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1 **Q1:   Please state your name and business address.**

2 A1:   My name is C. Kenneth Vogl. My business address is 101 South Hanley, Suite

3   900, St. Louis, Missouri 63105.

4 **Q2:   By whom and in what capacity are you employed?**

5 A2:   I am a Consultant with Towers Perrin. I serve as an actuary and employee

6   benefits consultant to a number of clients in the firm's St. Louis office.

7 **Q3:   Please describe Towers Perrin.**

8 A3:   Towers Perrin is an international management and actuarial consulting firm with

9   offices in 87 locations throughout the world. We serve approximately 7,000

10   clients worldwide in virtually every industry as well as in the government,

11   education, and not-for-profit sectors.

12 **Q4:   Please describe your education.**

13 A4:   I received a Bachelor of Science degree in mathematics from University of

14   Missouri, Columbia in 1988 and a Doctorate of Philosophy in mathematics from

15   Washington University in 1994. I completed the examination requirements for

16   designation as a Fellow of the Society of Actuaries and received such designation

17   in August 2000. I completed both the examination and experience requirements

18   for designation as an Enrolled Actuary under the Employee Retirement Income

19   Security Act of 1974 (ERISA) and received such designation in 1998.

20 **Q5:** **Please describe your qualifications.**

21 A5:   I have been employed with Towers Perrin as a consulting actuary since 1995.

22   From 1994 to 1995, I was employed by William Mercer in St. Louis. I have

23   substantial technical and consulting experience with regard to employee benefit

24   plans — including the design, funding, accounting, and communication of

25   pension and postretirement welfare programs.

26 **Q6:** **What is the purpose of your testimony?**

27 A6:   The purpose of my testimony is to rebut the testimony of David J. Effron —

28   which questions which actuarial study should be used for 2003 to measure

29   pension and postretirement benefits other than pensions ("OPEB") expense. I will

30   provide support for why Towers Perrin's approach to determine the fiscal 2003

31   expense is more appropriate. I will also show that the key assumptions and

32   methods used in the Towers Perrin valuation are reasonable, and even preferable,

33   given the current environment.

34 **Q7:** **What are the differences between the Towers Perrin study and the Buck**

35   **Consultants study?**

36 A7: First of all, the measurement dates are different. The Buck Consultants expense

37   results use a January 1, 2003 measurement date. The Towers Perrin results use a

38   February 1, 2003 measurement date. The February 1, 2003 measurement date

39   was used in the Towers Perrin study because the acquisition of CILCO by

40   Ameren, which took place on January 31, 2003, requires a remeasurement of

41   assets, liabilities, and expense for the subsequent period.

42   Secondly, the assumptions used to value the liabilities and return on assets

43   are different. Assumptions such as discount rate, salary scale, termination,

44   mortality, and retirement rates, etc. differ in the two studies. This is because Buck

45   Consultants used assumptions set by CILCO's former parent company, AES, with

46   the approval of the AES auditors as of January 1, 2003, while Towers Perrin used

47   assumptions set by CILCO's current parent company, Ameren, with the approval

48   of the Ameren auditors as of February 1, 2003.

49   Finally, the methods used to allocate the long-term cost of the plans to the

50   annual pension and OPEB expense are different. Specifically, the recognition of

51   gains or losses differs in the two studies. As with the assumptions, this is

52   because Buck Consultants used AES' methods while Towers Perrin used

53   Ameren's methods.

54 **Q8: Why is the Towers Perrin approach more appropriate?**

55 A8: According to Generally Accepted Accounting Principles (GAAP), the Fiscal 2003

56   pension and OPEB expense is comprised of two pieces because of the acquisition

57   of CILCO by Ameren on January 31, 2003. The expense is determined as

58   follows:

59   (1) 1/12 of the annual expense determined as of January 1, 2003

60   +

61   (2) 11/12 of the annual expense determined as of February 1, 2003

62   Piece (1) represents the one-month expense recognized prior to the

63   acquisition of CILCO. Because this piece was determined while CILCO was

64   controlled by AES, the calculated annual expense was based on the AES

65   assumptions and methods.

66   Piece (2) represents the eleven-month expense recognized after the

67   acquisition of CILCO. Because this piece is determined while CILCO is

68   controlled by Ameren, the calculated annual expense is based on the Ameren

69   assumptions and methods.

70   The above approach is used to determine the pension and OPEB expense

71   reported to shareholders. Clearly, it is appropriate to use this approach for

72   ratemaking analysis. In fact, it would be inappropriate to use assumptions and

73   methods different from those used to determine the ongoing pension and OPEB

74   expense.

75 **Q9:   Are the assumptions used by Ameren to measure liabilities more**

76   **conservative than those used by AES?**

77 A9:   In aggregate, no. As shown in the table below, the pension and OPEB liabilities

78   generated under each set of assumptions are similar. In fact, the OPEB liabilities

79 determined by Towers Perrin are lower than those determined by Buck

80 Consultants.

(in millions)	Buck Consultants at 1/1/2003	Towers Perrin at 2/1/2003
Pension liability	$353.2	$354.9
OPEB liability	$164.6	$155.9

81   The similar liabilities produced under both assumption sets show that the

82 net impact of changing the assumptions is small. The following summarizes

83 some of the key assumptions used and briefly describes which assumption is more

84 conservative.   As expected, some assumptions used by Ameren are more

85 conservative while others are less.

86   • Discount rate – Ameren uses a discount rate that is 50 basis points

87   higher than the discount rate used by AES. A lower discount rate

88   produces higher liabilities. Therefore, Ameren's discount rate is less

89   conservative.

90   • Salary increase rate − Ameren uses a salary increase rate that is 25

91   basis points higher than AES. A higher salary increase assumption

92   produces higher liabilities. Therefore, Ameren's salary scale is more

93   conservative.

94   • Mortality rates – Ameren uses a mortality table that has been updated

95   from the one used by AES. The updated mortality rates assume a

96   longer life expectancy and produce higher liabilities.   Therefore,

97   Ameren's mortality assumption is more conservative.

98   • Medical trend rates – While both Ameren and AES use a graded

99   schedule of medical trend rates, the Ameren rates are slightly lower

100   than those used by AES. The higher medical trend rates used by AES

101   will produce higher liabilities. Therefore, the Ameren assumption is

102   less conservative.

103   **Q10:** **Are the assumptions used by Ameren to determine pension and OPEB**

104   **expense more conservative than those used by AES?**

105   A10: In aggregate, yes. Although the assumptions used by Ameren do not produce

106   higher liabilities, they do produce higher expense. However, the increase in

107   expense is primarily the result of the following two assumptions:

108   • Expected rate of return on assets

109   • Mortality

110   **Q11:** **Please describe the key assumptions used by Ameren that result in higher**

111   **expense and state why they are appropriate.**

112   A11: Although demographic and economic assumptions are important, the key

113   assumptions used by Ameren that produce higher expense are as follows:

114   • Expected rate of return on assets of 8.50%

115   The expected rate of return on assets is generally set based on long-term

116   expectations of investment return. Historically, Ameren has set this assumption at

117   8.50%. Recent poor investment performance has other companies lowering this

118   rate to Ameren's level. For example, Towers Perrin's recent survey of companies

119   in the Fortune 100 shows that the median expected rate of return disclosed at

120   December 31, 2002 was 8.75% for fiscal 2002 expense purposes, down 50 basis

121   points from one year earlier. Analysts, auditors, and the SEC are beginning to

122   question expected rates of return at or above 9.00%. As a result, we expect the

123   median return on assets to be lower than 8.75% for 2003 expense purposes.

124   • Mortality rates from the 1994 Group Annuity Reserving Table (1994

125   GAR)

126   The mortality assumption needs to be changed periodically as updated

127   tables become available. Ameren found it appropriate to update the mortality

128   assumption to 1994 GAR in 1999. Companies that have not already updated their

129   mortality assumption should be doing so in the near future.

130   Based on the above, we believe the expected return on assets and mortality

131   assumption used by Ameren better reflect the true cost of the plan and are

132   therefore more appropriate.

133   **Q12:   Please describe any other factors that result in higher expense and state why**

134   **they are appropriate.**

135   A12: Ameren's accounting method for recognition of pension and OPEB expense is

136   different than the method used by AES. The primary difference that results in

137   higher expense levels is the recognition of actuarial gains and losses in the

138   calculation of annual expense.

139   Ameren, since its adoption of FAS 87 and FAS 106, has recognized some

140   portion of its total unrecognized gains and losses into expense each year (i.e.,

141   Ameren does not use a corridor approach). An advantage of this approach is that

142   it does not defer recognition of gains and losses to future ratepayers, which seems

143   to provide more equity between generations of ratepayers.

144   In addition, because recent economic experience has generated losses,

145   there is discussion among the governing bodies (e.g., SEC, FASB, IASB) to

146   lessen the deferral of actuarial gains and losses currently allowed by FAS 87 and

147   FAS 106.

148 **Q13:** **Would you like to briefly summarize your surrebuttal testimony?**

149 A13: Yes. First of all, I believe Towers Perrin's determination of the fiscal 2003

150   pension and OPEB expense is the appropriate way to determine expense for 2003.

151   Because CILCO was acquired by Ameren on January 31, 2003, eleven-twelfths of

152   the fiscal 2003 pension and OPEB expense must be determined based on Ameren

153   assumptions and methods.

154   I have also shown that the key assumptions and methods used by Ameren

155   are reasonable, and even preferable, given the current environment.

156 **Q14:** **Does this conclude your surrebuttal testimony?**

157 A14: Yes.